No. 87-267.

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In the Supreme Court of the United States.

OCTOBER TERM, 1987.

D.H. HOLMES CO., LTD.,
APPELLANT,

v.

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SHIRLEY McNAMARA,
SECRETARY OF REVENUE AND TAXATION,
THE DEPARTMENT OF REVENUE AND TAXATION,
STATE OF LOUISIANA,
APPELLEE.

ON APPEAL FROM THE COURT OF APPEAL,
FOURTH CIRCUIT, STATE OF LOUISIANA.

BRIEF OF AMICUS CURIAE DIRECT MARKETING ASSOCIATION IN SUPPORT OF APPELLANT D.H. HOLMES CO., LTD.

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Statement of Interest of Direct Marketing Association.

The Direct Marketing Association ("DMA") files this brief in support of the position of Petitioner, D.H. Holmes, Inc. ("Holmes"). Written consent of both of the parties to the filing by DMA as an *amicus* is on file with the Clerk's office of the Court.

Direct Marketing Association, Inc. (DMA), a New York not-for-profit corporation, is the largest and oldest national trade association representing companies involved in direct-to-the-consumer mail advertising and marketing. DMA's membership totals more than 3,200 firms located in all 50 states and 40 foreign countries. A majority of the association's members are mail order houses. Members range in size from small enterprises, including operations that continue to prepare their catalogs on kitchen table tops, to "Fortune 500" companies.

As an association that consists of many businesses that sell only by use of the means of interstate commerce, DMA is concerned about language in the decision of the Louisiana Court of Appeals suggesting that the constitutional requirement of nexus may be established by the presence of customers in the taxing state and the sending of advertisements and other materials by the instrumentalities of interstate commerce to residents of the taxing state. This Court has repeatedly held that the presence of customers in the taxing state, the sending of advertising materials to residents of the state and the delivery of goods into the state are *not* factors indicating nexus. If nexus for purposes of a direct use tax is based upon any of these factors, then such factors could be used to establish nexus for purposes of use tax collection as well. Thus, mail order houses that do an interstate business but have no physical presence in the state may be required to collect the use tax in the 45 states and 7,000 local jurisdictions that have sales and use tax statutes. The administrative burden and expense would have a far-reaching effect on interstate commerce. DMA submits this brief to explain why the Louisiana Court's views of nexus should be rejected by the United States Supreme Court.

Summary of Argument.

Nexus with the taxing state is the necessary constitutional link to justify a state's imposing a use tax on a taxpayer, as was done by the Louisiana Department of Revenue on Holmes in the instant case (a "direct use tax"). Nexus is also required in the situation where a state requires an out-of-state company to collect a use tax on behalf of the state from the actual in-state users of the goods, as was the situation presented in *National Bellas Hess, Inc.* v. *Department of Revenue,* 386 U.S. 753 (1967). For the direct use tax, the state must establish a nexus between the state and the activity that is the subject of taxation. However, for use tax collection purposes, nexus is established by looking at all the activities of the company within the state, regardless of whether such activities themselves are subject to the tax. *National Geographic Society* v. *California Board of Equalization,* 430 U.S. 551, 560-561 (1977).

The language of the Louisiana Court of Appeals decision suggesting that nexus can be established by the presence of customers in the taxing state and the mailing of advertising materials to residents of the state is flatly inconsistent with the long line of decisions of this Court interpreting the Commerce Clause and the Due Process Clause of the U.S. Constitution. The Court has consistently held that a state may impose a tax on an activity in connection with interstate commerce *only* if the activity itself is conducted within the state. Similarly, this Court has held that for use tax collection purposes, nexus requires that the taxpayer do business in the state through the maintenance of facilities, property, goods, employees, agents or other representatives in the state. However, connections with the taxing state through the mails, interstate means of transportation, and advertisements directed to its residents, along with delivery of goods to residents of the state by common carrier, are not factors to establish the nexus required by

the Constitution either for purposes of the direct use tax or use tax collection.

The Court has adopted this definition of nexus in order to reconcile the competing interests of the states in obtaining tax revenues and the national interest of a single, open economy as embodied in the Commerce Clause. If the overly broad position of the Louisiana Court of Appeals regarding nexus were adopted by this Court, the delicate balance drawn by this Court in weighing the revenue needs of the states and the maintenance of an open, national market would be upset. In fact, the time-honored principle of nexus would be rendered meaningless.

The mere distribution of printed matter through the mails or the delivery of goods by other instruments of interstate commerce should not be deemed sufficient to justify either imposition of a use tax or delegation of tax collection responsibilities. Adoption of the Louisiana Court's application of nexus principles would place on companies such as mail order houses the overwhelming administrative burden and expense of complying with the laws of the 45 states and 7,000 local governments that have sales and use tax laws. Interstate commerce would be immutably harmed as a result.

Argument.

THE CONSTITUTIONAL REQUIREMENT THAT A STATE HAVE "NEXUS" WITH AN ACTIVITY IT SEEKS TO TAX IS SATISFIED ONLY WHEN THE TAXPAYER CONDUCTS THE TAXABLE ACTIVITY WITHIN THE STATE; THE PRESENCE OF CUSTOMERS WITHIN A STATE AND THE DISTRIBUTION OF ADVERTISING MATERIALS AND OTHER ITEMS BY MAIL AND COMMON CARRIER INTO A STATE DO NOT ESTABLISH NEXUS.

The threshold criterion for determining the constitutionality of state taxes assessed on activities in connection with interstate

commerce or imposed upon a company or person located outside the state is "nexus." Nexus is the constitutional prerequisite for a state to impose a tax, whether it is the state's income tax on a non-resident;[1] or a gross receipts or occupation tax on the activities of a company engaged solely in interstate commerce;[2] or the deputization of an out-of-state firm to collect the state's use tax.[3] Nexus is necessary to satisfy the requirements of both the Commerce Clause and the Due Process Clause of the Constitution. *Container Corp. of America* v. *Francise Tax Bd.*, 463 U.S. 159, 164 (1983).

The question of whether nexus exists can arise in the case of a use tax in two contexts. First, the tax may be a direct tax on the taxpayer's use of a product in state. Louisiana in this case has imposed a direct tax on Holmes. Second, a state may seek to deputize an out-of-state company *to collect* the use tax for the use of goods by residents of the state. This question primarily arises in the case of mail order houses. *National Bellas Hess, Inc.* v. *Department of Revenue*, 386 U.S. 753 (1967).

For a direct tax, such as a direct use tax, the Court has required a substantial nexus between the taxing state and the "use" — the taxable activity. *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 279 (1977) (holding that a direct sales tax on Complete Auto Transit required a substantial nexus between the taxing state and the taxable activity). Cf. *National Geographic Society* v. *California Board of Equalization*, 430

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[1] *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 464 (1959); *Wisconsin* v. *J.C. Penney Co.*, 311 U.S. 435, 445 (1940).

[2] *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 279 (1977); *Department of Revenue* v. *Association of Washington Stevedoring Companies*, 435 U.S. 734, 750 (1978).

[3] *National Geographic Society* v. *California Board of Equalization*, 430 U.S. 551, 556 (1977); *National Bellas Hess, Inc.* v. *Department of Revenue*, 386 U.S. 753, 758 (1967).

U.S. 551, 560-561 (1977) (drawing a distinction between direct tax cases, where the nexus must be established with the taxable activity itself, and use tax collection cases, as presented in *National Geographic*, where the nexus can be established with the taxpayer by considering *all* the activities of the taxpayer in the taxing state). For use tax collection purposes, nexus must be established between the state and the out-of-state company. *National Geographic Society* v. *California Board of Equalization*, 430 U.S. 551, 561 (1977). In either type of case, the "target" of the state's taxing authority — the transaction subject to tax in the case of a direct tax and the company's business operations in the case of a duty to collect the use tax — must have the requisite nexus, i.e., connecting link, with the state. For both types of cases, nexus must result from the in-state presence of the target of the state's taxing authority. For both, this Court has ruled that the presence of customers in a state, the sending by mail of advertisements to the state and the delivery by common carrier of goods to residents of the state are *not* factors to establish nexus.

The Louisiana Court of Appeals' opinion in this case suggests, however, that the nexus requirement may be satisfied by the presence of customers of the taxpayer in the taxing state. *McNamara* v. *D.H. Holmes Co., Ltd.*, 505 So.2d 102, 106 (La. App. 4th Cir. 1987).[4] The opinion also indicates that

[4]The lower court found as follows:

> The nexus requirement is met because Holmes operates 13 stores intrastate. It has approximately 5,000 Louisiana employees, 500,000 charge customers, and 1,500,000 customers within the state. 82% of the total number of catalogs were mailed into Louisiana and 1,000 were distributed from the Canal Street Store.

The court appears to state that nexus may be based upon the presence of Holmes' customers in the State. This may not be part of the court's holding and simply an additional observation, for the maintenance of retail stores in a

nexus can be based upon the distribution through the mails or by common carrier of advertising materials to residents of the taxing jurisdiction. *Id.* at 105.

In the case at bar, the taxpayer maintains retail stores and employees in Louisiana. Although Holmes is clearly conducting business activities within the state, this Court in *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 279 (1977), recognized that in the case of a direct tax the Commerce Clause requires that "the tax is applied to *an activity* with a substantial nexus with the taxing state." (Emphasis added) Similarly, in *American Oil Co.* v. *Neill*, 380 U.S. 451, 458 (1965), the Court held that even if a company is doing business within the state, it would violate the Due Process Clause if the state imposed a tax on a transaction involving "no in-state activities". This Court in *National Geographic Society* v. *California Board of Equalization*, 430 U.S. 551, 560-561 (1977), reaffirmed the principle set forth in *American Oil* that a "direct tax" on a transaction will be sustained only when there is both a nexus between the seller and the state and a nexus between the activity taxed and a seller's activity in the state.[5]

The use tax Louisiana imposed on Holmes is a direct tax on Holmes' mailing of catalogs to Louisiana residents. As Holmes will argue in its brief, Holmes was not conducting any business activities within Louisiana in connection with the transaction sought to be taxed by Louisiana — the distribution of catalogs. Holmes used the U.S. mail to send its catalogs

state alone is sufficient to provide nexus to the taxpayer. On the other hand, it may be an element of nexus relied on by the court. It is this interpretation of the lower court's opinion that raises one of the concerns addressed in this brief.

[5]The *National Geographic* Court, however, did hold that an out-of-state company may be required to collect the state's use tax without a showing of the connection between the company's in-state presence and the *particular* transaction taxed. 430 U.S. at 561.

to Louisiana residents. Holmes neither took possession nor control of the catalogs in Louisiana. Therefore, the necessary nexus to the taxable transaction is not satisfied in this case.[6]

This brief examines the essential elements of the nexus standard and discusses the mischaracterization of these elements by the lower court.[7] The lower court's interpretation of what can constitute nexus is directly contrary to a long line of Supreme Court decisions interpreting the Commerce Clause and Due Process Clause requirements. Indeed, the effect of adopting this overly broad view of nexus would be to abandon any limits on state taxing authority, by virtue of the Commerce Clause and Due Process Clause, in the areas of direct use tax and use tax collection.

[6]Holmes mailed the catalogs that were subject to the Louisiana use tax. Once items are placed in the mail, the sender can exercise no control over them. 18 U.S.C. § 1708; 39 C.F.R. § 152.77. Thus, Holmes relinquished all control over the catalogs at the places from which they were shipped.

[7]An additional question in this case which this brief will not address in detail is whether the use tax imposed by Louisiana can be sustained under the Commerce Clause, because there is a risk of multiple taxation. The tax imposed by Louisiana on distribution of the catalogs is a tax on goods in the course of interstate commerce, since the taxpayer's only distribution of the items was by use of an instrument of interstate commerce, the U.S. mail. At no time did the taxpayer control or take possession of the catalogs in Louisiana. Once the catalogs reached the mailbox of the Louisiana resident — the only connection to Louisiana — it was only the Louisiana resident, and not the taxpayer, that decided what to do with the catalogs. If Louisiana could impose a use tax on distribution, so could every state through which the mail passes. This would expose interstate commerce to possible multiple tax burdens. P. Hartman, *Federal Limitations on State and Local Taxation* § 2.18 (1981); J. Hellerstein, 1 *State Taxation* § 4.11 (1983). Therefore, even though there is no evidence of *actual* multiple tax burdens in the case at bar, this Court has recently held that it is the *possible* risk of multiple taxation that constitutes grounds for invalidating a state tax on Commerce Clause grounds. *Tyler Pipe Industries, Inc.* v. *Washington State Dept. of Revenue*, U.S. , 107 S.Ct. 2810, 2817 (1987); *Armco, Inc.* v. *Hardesty*, 467 U.S. 638, 642 (1984).

A. *The Nexus Requirement of Carrying on In-State Business Activities Establishes the Proper Balance between the State's Interest in Taxation and the Constitutional Limits of a State's Power To Tax.*

The primary goal of the Commerce Clause and its interplay with the Due Process Clause is to secure a unified, national market unimpeded by state-imposed burdens and restraints against trade across state lines. P. Hartman, *Federal Limitations on State and Local Taxation* §§2.2, 2.3 (1981). At the same time, in our federal system a state has a legitimate interest in taxing business activities that occur within its borders. The sovereign interests of a state, however, must stop at its borders. This Court has established the nexus standard of in-state business activities, "to make the delicate adjustment between the national interest in free and open trade and the legitimate interest of the individual states in exercising their taxing powers." *Boston Stock Exchange* v. *State Tax Commission*, 429 U.S. 318, 329 (1977). See also *McGoldrick* v. *Berwind-White Coal Mining Co.*, 309 U.S. 33, 48 (1940) (the question of whether a tax on interstate activities is permissible requires courts "to reconcile competing constitutional demands, that commerce between the states shall not be unduly impeded by state action, and that the power to lay taxes for the support of state government shall not be unduly curtailed").

The "very purpose of the Commerce Clause was to create an area of free trade among the several States." *McLeod* v. *J.E. Dilworth Co.*, 322 U.S. 327, 330 (1944). The Supreme Court, therefore, has long recognized the need to protect the national economy against state laws insufficiently related to activities within the taxing state. *Freeman* v. *Hewit*, 329 U.S. 249, 252 (1946) (the "Commerce Clause . . . is a limitation upon the power of the States"). Thus, in a case involving a severance tax on raw materials, the Court held that the "inter-

state business must have a substantial nexus with the State . . . and the measure of the tax must be reasonably related to the extent of the contact, since it is the activities or presence of the taxpayer in the State that may properly be made to bear a 'just share of tax burden.'" *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 626 (1981), quoting *Western Live Stock* v. *Bureau of Revenue*, 303 U.S. 250, 254 (1938). See also *General Motors Corp.* v. *Washington*, 377 U.S. 436, 440-441 (1964) (question under Commerce Clause is whether the state has exerted its power in proper proportion to appellant's activities within the state).

Just as a state in our federal system has broad powers to tax activities occurring within that state, it is "impotent" under the Due Process Clause to tax business or activities conducted outside its borders. *Wisconsin* v. *J.C. Penney Co.*, 311 U.S. 435, 444-446 (1940); *Connecticut General Life Insurance Co.* v. *Johnson*, 303 U.S. 77, 80-81 (1938).[8] In the case of an income tax, for example, a state "may not tax value earned outside its borders." *Asarco, Inc.* v. *Idaho*, 458 U.S. 307, 315 (1982). The Court has required that a tax may be sustained under the Due Process Clause only when there is "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Bros. Co.* v. *Maryland*, 347 U.S. 340, 345 (1954). Thus, as this Court has recently stated in considering the constitutionality of a state income tax on a nonresident corporation, "[t]he requisite 'nexus' is supplied if the corporation avails itself of the 'substantial privilege of carrying on business' within the State."

[8]Holmes conducted no activities in Louisiana in connection with the transaction taxed — the distribution of catalogs. Its involvement was merely to cause the catalogs to be placed in the U.S. mail from points outside Louisiana. Since the sender relinquishes control over an item once given to the Post Office, Holmes had no control over the catalogs once they left interstate commerce, i.e., were placed in the mailboxes of the Louisiana residents.

Mobil Oil Corp. v. *Commissioner of Taxes*, 445 U.S. 425, 437 (1980), quoting *Wisconsin* v. *J.C. Penney Co.*, 311 U.S. at 444-445. See also *Container Corp. of America* v. *Franchise Tax Bd.*, 463 U.S. 159, 166 (1983) (Due Process nexus "imposes the obvious and largely self-executing limitation that a State not tax . . . [a business] unless at least some part of it is conducted in the State"); *Exxon Corp.* v. *Department of Revenue*, 447 U.S. 207, 208 (1980) (Due Process nexus established "if the corporation avails itself of the substantial privilege of carrying on business within the State").

In short, it is only when local business activities are conducted that the necessary constitutional nexus is present. In such situations, the taxing power exerted by the state "bears fiscal relationship to protection, opportunities and benefits given by the state" to the taxpayer, *Wisconsin* v. *J.C. Penney Co.*, 311 U.S. 435, 444 (1940), and, therefore, the state's interest in taxation outweighs the limits on the state's power under the Constitution. As stated in *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 627 (1981):

> *When a tax is assessed in proportion to a taxpayer's activities or presence in a State*, the taxpayer is shouldering its fair share of supporting the State's provision of "police and fire protection, the benefit of a trained work force, and the advantages of a civilized society." [quoting *Exxon Corp.* v. *Department of Revenue*, 447 U.S. 207, 228 (1980), emphasis added.]

When, however, there is no presence within the state, the state's interest in taxation is outweighed by the national interest. Where the firm is not carrying on business activities within the state, the tax is an attempt to reach "extraterritorial

values"; thus the tax "does not bear the necessary relationship to opportunities, benefits, or protections conferred or afforded by the taxing State." *F.W. Woolworth Co.* v. *Taxation & Revenue Dept.*, 458 U.S. 354, 372 (1982) (quoting *Norfolk & Western R. Co.* v. *Missouri State Tax Comm'n*, 390 U.S. 317, 325 n.5 (1968).

B. *The Presence of Customers in a State and the Distribution of Advertising Materials and Other Items by U.S. Mail and Common Carrier into a State Does Not Constitute Sufficient Nexus To Permit the Direct Imposition of a Use Tax on Advertising Materials or the Delegation of a Duty To Collect Sales or Use Taxes from Customers.*

Nexus standards in tax cases have been well developed by this Court in its line of use tax collection decisions. In these cases, the Court has held that the presence of customers and the delivery of merchandise and advertisements by U.S. mail and common carrier do not constitute nexus. Therefore, neither should these factors constitute nexus for the purpose of imposing a direct use tax.

In use tax collection cases, the Court has drawn a clear line between firms that have offices, property or agents, such as solicitors in the taxing state, and those firms which do not have such local presence. As the Court stated in *National Bella Hess, Inc.* v. *Department of Revenue*, 386 U.S. 753, 758 (1967), there is a "sharp distinction . . . between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business."

In *Nelson* v. *Sears, Roebuck & Co.*, 312 U.S. 359 (1941), the Court considered one of the first challenges to the constitutionality of imposing use tax collection duties on retailers.

There, the Court clearly distinguished between a mail order firm that has a local office and a concern that does not have such a presence within the state. The mail order firm with a local office, according to the Court, could be required to assume the burden of local tax collection "as a price of enjoying the full benefits flowing from" maintenance of the office. *Id.* at 364. A firm that does not maintain an office, however, is "not receiving benefits from" the taxing jurisdiction for which the state "has the power to exact a price." *Id.* at 365. That the state could not obligate the mail order concern to collect its taxes is "a result of the impotence of state power." *Id.* at 364, quoting *Wisconsin* v. *J.C. Penney Co.*, 311 U.S. 435 (1940).[9]

In *Miller Bros. Co.* v. *Maryland*, 347 U.S. 340 (1954), a Delaware vendor, located just over the state line from Maryland, had significant sales to Maryland residents from its Delaware store. In fact, for certain purchases over a specified amount, employees of Miller Bros. made deliveries into Maryland with company-owned delivery trucks. In addition, the Delaware retailer advertised in Delaware-media, which were distributed to and received by Maryland residents. Miller Bros. also mailed announcements of various sales and promotions to Maryland residents. Notwithstanding these contacts with Maryland residents, the Court ruled that there was an insufficient nexus between the Delaware vendor and Maryland to justify imposition on Miller Bros. of the duty to collect the use tax. The Court stated that the "burden of collecting or paying" the use tax "cannot be shifted to a foreign merchant in

[9]To similar effect are the decisions in *Nelson* v. *Montgomery Ward & Co.*, 312 U.S. 373, 375 (1941) (maintenance of local retail outlets); *Scripto, Inc.* v. *Carson*, 362 U.S. 207, 209 (1960) (retention of ten brokers (solicitors) in the taxing jurisdiction); *Standard Pressed Steel Co.* v. *Department of Revenue*, 419 U.S. 560, 561 (1975) (employee located in state made possible the "realization and continuance of valuable contractual relations" for the taxpayer, the proceeds from which contracts were taxed).

the absence of some jurisdictional basis not present here." *Id.* at 347. The "definite link" necessary to provide "an adequate basis for taxation" would be present, according to the Court, where the retailer or its employees or agents maintain a "domicile or residence, more substantial than mere presence in transit or sojourn." *Id.* at 344-345. The connection to the state required by the Due Process Clause simply was not present in that case. *Id.* The Court ruled against Maryland despite the dissenting opinion which argued that there were substantial connections with Maryland, since there had "been a course of conduct in which the appellant has regularly injected advertising into media reaching Maryland customers and regularly effected deliveries within Maryland by its own delivery trucks and by common carriers." *Id.* at 358.

The majority's opinion in *Miller Bros.* regarding the level of contacts necessary to satisfy the nexus standard is directly contrary to the suggestions in the Louisiana Court of Appeals decision that nexus can be based on sales to residents of Louisiana and the distribution of advertising materials to them. This Court has clearly drawn a line between, on the one hand, visits to a taxing state by employees using company-owned property and advertising directed to residents of that state (i.e., the *Miller Bros.* situation which did not create nexus for use tax collection purposes), and, on the other hand, "active and aggressive operation within a taxing state" by running a retail store, as in *Nelson* v. *Sears, Roebuck & Co., supra,* or an "out-of-state merchant entering the taxing state through traveling sales agents to conduct continuous local solicitation followed by delivery of ordered goods to the customers" in the case of *General Trading Co.* v. *State Tax Commission,* 322 U.S. 335 (1944). 347 U.S. at 346-347. Thus, it is only where "a corporation, pursuant to permission given, enters a State and proceeds to do business" will the definite link to sustain

a direct tax on the business or to uphold use tax collection be found. *American Oil Co.* v. *Neill,* 380 U.S. 451, 458 (1965).

The *Miller Bros.* holding was specifically reaffirmed in *National Bellas Hess, Inc.* v. *Department of Revenue,* 386 U.S. 753, 758 (1967). In that case, the Court held that a mail order firm that does not maintain retail outlets, property or solicitors within a state is immune from that state's taxing authority. *Id.* at 758. As the Court stated, "[t]he case in this Court which represents the furthest constitutional reach to date of a State's power to deputize an out-of-state retailer as its collection agent for a use tax is *Scripto*," where "the seller had ten wholesalers, jobbers or salesmen conducting continuous local solicitation." *Id.* at 757. By a six to three majority, the Court struck down the Illinois statute.

In a vigorous dissenting opinion, Justice Fortas, joined by Justices Black and Douglas, argued that the presence of customers in a state and the solicitation of such customers by advertisements in the mail constituted sufficient nexus. According to Justice Fortas, National Bellas Hess was exploiting "the consumer market of Illinois . . . by soliciting residents of Illinois who live and work there and have home and banking connections there. . . . Bellas Hess could not carry on its business in Illinois, and particularly its substantial credit business, without utilizing Illinois banking and credit facilities." The majority, however, refused to accept the dissent's argument that National Bellas Hess was enjoying "the benefits of, and profits from the facilities nurtured by, the State of Illinois as fully as if it were a retail store or maintained salesmen therein." *Id.* at 762.

The principle that the substantial nexus required under the Commerce and Due Process Clauses is satisfied only by presence within the state remains good law. In *National Geographic Society* v. *California Board of Equalization,* 430 U.S. 551, 559 (1977), the Court specifically approved the distinction

drawn in *National Bellas Hess* and other Supreme Court decisions between mail order firms with a physical presence in the state and those whose connection with the jurisdiction consisted solely of conducting an interstate business. Because the National Geographic Society maintained two offices in California, the state was allowed to impose the duty to collect the tax. *Id.* The Court, however, declined to adopt the California Supreme Court's test that the "slightest presence" within a taxing state was sufficient under the Commerce and Due Process Clauses, lest virtually every out-of-state seller would be made liable for the use tax. *Id.* at 555.

This Court has recently noted the relevance of its application of nexus principles in use tax collection cases to nexus requirements in direct taxation cases. In *Tyler Pipe Industries, Inc.* v. *Washington State Department of Revenue*, U.S. , 107 S.Ct. 2810, 2821-2822 (1987), a case concerning the State of Washington's gross receipts tax, the Court cited its use tax collection decisions in *Scripto* and *National Geographic* in confirming that "the crucial factor governing nexus is whether *the activities performed in this state* [the taxing state] *on behalf of the taxpayer* [by its in-state sales representative] are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." (Emphasis added, quoting Washington Supreme Court opinion.)[10]

[10]The Court has also cited *National Bellas Hess* as providing the appropriate nexus standard under the Commerce Clause and Due Process Clause to determine the validity of other state taxes. See, e.g., *Asarco, Inc.* v. *Idaho*, 458 U.S. 307, 316 (1982); *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 626 (1981); *Exxon Corp.* v. *Department of Revenue*, 447 U.S. 207, 219-220 (1980); *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425, 436-437 (1980); *Moorman Manufacturing Co.* v. *Bair*, 437 U.S. 267, 273 (1978).

C. *Adoption of a Nexus Standard Based on the Presence of Customers in a State and the Distribution of Materials through the Mail or by Other Instruments of Interstate Commerce Would Render Meaningless the Clear Constitutional Limitations on a State's Power to Tax, Particularly in the Case of a Mail Order House.*

As discussed above, the approach to nexus suggested by the Louisiana Court of Appeals, in essence, would abandon the clear principle adopted and followed in a long line of cases interpreting the Commerce and Due Process Clauses to limit a state's taxing power to activities conducted by the taxpayer within the state. Although use tax collection was not at issue in the lower court's decision, under the lower court's approach to nexus a company, wherever located, which had sold merchandise to residents of a distant state or circulated materials by common carrier there, would be subject to the duty to collect the state's use tax, regardless of the fact that the company itself had maintained no offices, property, employees or agents in the state and irrespective of the fact that the company had not been reaping any of the benefits or protections of the taxing state. For an interstate trader such as a mail order house that sells and sends its catalogs throughout the United States, this definition of nexus would require the collection and remittance of sales and use taxes on its sales of merchandise to residents throughout the United States and would require the payment of use taxes on the value of advertising materials sent throughout the United States.

Abandonment of traditional Commerce Clause and Due Process Clause limitations upon a state's authority to extend its taxing authority beyond its borders would impose a heavy and disproportionate administrative burden and expense on

mail order firms, even though the mail order companies receive no benefit from the local tax revenues they would be asked to collect and remit to the states. It would, in effect, penalize interstate commerce and lessen the ability of mail order companies to offer the unique service which they provide to American consumers.[11] A mail order house would be forced to collect use taxes in the 45 states and more than 7,000 local jurisdictions in the United States having such taxes[12] and would be required to pay use taxes to each of these jurisdictions on

[11] Since the early 19th century, mail order companies have provided a unique and important service to certain segments of the American public. To residents of rural areas, mail order compensates for their remoteness from urban retail centers. To the aged and handicapped who are home-bound, mail order brings the marketplace to their door. To working couples who lack the time or child care arrangements for store shopping, mail order is a quick and efficient way of making their purchases. Moreover, mail order enriches the diversity of goods available to people in widely-separated regions of the country. The free and open market made possible by the Commerce Clause has made these developments possible.

[12] The Advisory Commission On Intergovernmental Relations, a non-partisan Congressionally authorized body, has examined the issue of state and local taxation of interstate mail order sales in the context of possible federal legislation. In its Executive Summary dated August 26, 1985, the ACIR recognized the significance of several controverted issues, including compliance burdens on mail order companies:

> *Heavy Compliance Burdens*: The mail order firms would be forced to shoulder extraordinary compliance burdens if they are required to comply with the differing tax code provisions of 45 states and 7,000 local governments that are now imposing sales taxes.

(Page 2 of Executive Summary, dated August 26, 1985.) Consequently, in its recommendations for federal legislation on this subject, "in order to minimize compliance costs for firms operating in multiple jurisdictions," the ACIR proposed that a "non-discriminatory single rate" be established. (Recommendation of Advisory Commission On Intergovernmental Relations, dated September 20, 1985.)

the value of materials mailed to addresses within these jurisdictions. The costs and problems to direct marketers would be substantial, and would have a deleterious effect on the mail order industry.

The dilemma and hardship a mail order firm would encounter if it were required to collect the sales and use tax in a large number of states and localities were underscored by the Court in *National Bellas Hess*, 386 U.S. at 759-760:

> And if the power of Illinois to impose use tax burdens upon National were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote. For if Illinois can impose such burdens, so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the Nation with power to impose sales and use taxes. The many variations in rates of tax, in allowable exemptions and in administrative and record-keeping requirements could entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose "a fair share of the cost to the local government."
>
> The very purpose of the Commerce Clause was to insure a national economy free from such unjustifiable local entanglements. [Footnotes omitted.]

The point is not whether tax collection is possible. The question is whether there is any reason to reverse the U.S. Supreme Court's decisions which are based on fundamental principles of federalism. A state may not export to a foreign company that does not do business within the state's borders

the type of administrative burden that would occur if the Louisiana Court of Appeals' approach to nexus were adopted. The practical effect of this radical approach would hold hostage the privilege of participating in the national market created by virtue of the Commerce Clause.

Conclusion.

This Court has repeatedly required a presence in the taxing state of the target of taxation to establish the nexus standard under the Commerce and Due Process Clauses. This standard is based on the delicate balance between the states' powers to tax and the interest in a national market. This time-honored principle should not be disturbed.

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